Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

KATHLEEN A. SHEFCHUK, AS EXECUTRIX
OF THE ESTATE OF GREGORY D. SHEFCHUK, PETITIONER

v.

ILLINOIS UNION INSURANCE COMPANY;
ROBERT C. SHEFCHUK

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Court of Appeals must dispose of a case consistent with the language of the body of its Opinion.

PARTIES TO THE PROCEEDING

Petitioner is Kathleen A. Shefchuk as Executrix of the Estate of Gregory D. Shefchuk, deceased, having been so appointed by the Geauga County, Ohio, probate court.

Respondent is Illinois Union Insurance Company. According to a disclosure statement filed in the Court of Appeals, Illinois Union Insurance Company is a subsidiary of Pacific Employer's Insurance Company. Pacific Employer's Insurance Company is a subsidiary of ACE, Ltd., which is publicly owned.

In addition to these parties, the following was a party to the proceedings in the Court of Appeals:

Robert C. Shefchuk, the father of Gregory D. Shefchuk. Subsequent to the Decision of the Court of Appeals, all issues between Robert C. Shefchuk and Illinois Union Insurance Company were settled in the District Court.

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In the

Supreme Court of the United States

KATHLEEN A. SHEFCHUK, EXECUTRIX OF THE ESTATE OF GREGORY D. SHEFCHUK

Petitioner,

v.

ILLINOIS UNION INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner, Kathleen A. Shefchuk, Executrix of the Estate of Gregory D. Shefchuk, deceased ("Executrix") or ("the Estate") respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Sixth Circuit was entered "per curiam" and stamped "not recommended for full-text publication." It is not reported. It is reproduced in the Appendix at 1(a). The opinion was amended by Order of the Sixth Circuit panel Denying Petition for Rehearing issued November 30, 2005. That is unreported and is reproduced at App. 57(a). The Memorandum and Order of the United States District Court for the Northern District Court of Ohio denying Petitioner's Motion for Summary Judgment and

granting that of Respondent Illinois Union Insurance Company ("Illinois Union") (and also granting in part and denying in part the summary judgment motions of Illinois Union and Robert C. Shefchuk) was entered September 7, 2001. It is unreported and is reproduced in the Appendix at App. 25(a). By Judgment Entry of May 23, 2002, the district court finalized the Memorandum and Order of September 7, 2001. This Judgment Entry is unreported and is reproduced in the Appendix at App. 53(a).

JURISDICTION

The United States Court of Appeals for the Sixth Circuit issued its Opinion on August 17, 2004. A timely petition for Panel Rehearing was denied on November 30, 2005. A timely application of Petitioner to extend time to file a Petition for Writ of Certiorari was granted by Justice John Paul Stevens as Circuit Justice for the United States Court of Appeals for the Sixth Circuit on February 15, 2006, extending the time for filing a Petition Writ of Certiorari to April 29, 2006, a Saturday. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The oath of office prescribed for all federal justices and judges by 28 U.S.C. § 453 requires them "to administer justice without respect to person" and to "faithfully and impartially discharge all duties."

Under 28 U.S.C. § 2106, appellate courts are to make rulings and direct further proceedings "as may be just under the circumstances."

These statutes are reproduced in the Appendix.

STATEMENT

This Petition seeks review of a decision of the United States Court of Appeals for the Sixth Circuit that, as to the Petitioner Executrix and the Estate that she represents, affirmed in all respects the ruling by the district court on summary judgment that the Executrix was not entitled to insurance coverage for defense costs. The Sixth Circuit's Opinion found that the district court had erred and failed to follow Ohio law in not analyzing the allegations of pleadings in underlying cases and that reversal would be justified as to the Executrix. However, the language of the Conclusion of the Court of Appeals' Opinion stated, and continues to state, that the district court's judgment is affirmed.

That such a disposition by a Court of Appeals, totally inconsistent with the law and facts as determined by the Court of Appeals, is contrary to the most fundamental purposes and concepts of the American system of justice should be recognized and corrected by the Supreme Court.

The underlying controversy between the Executrix and Illinois Union involves questions of insurance coverage, primarily for defense costs, under Ohio law. The merits of Ohio insurance coverage law is not what would be at issue on the review on Writ of Certiorari sought by Petitioner. This Petition only concerns the failure of the Court of Appeals to dispose of the matter in the Court of Appeals, and to remand it to the district court with instructions, consistent with the

determinations as to Ohio law on insurance coverage as made by the Court of Appeals.

Gregory Shefchuk and his father, Robert Shefchuk, operated RCS Financial Services, Inc., an Ohio corporation. The Shefchuks were representatives for Money Concepts Capital Corporation, selling mutual funds and other financial products to Ohio residents. Illinois Union Insurance Company issued a professional liability policy to Money Concepts that covered both Robert Shefchuk and Gregory Shefchuk as insureds.

About April, 1998, a lawsuit was filed in an Ohio state court against both Shefchuks, their company, and Money Concepts by a client/investor, and in May, 1998, Gregory Shefchuk committed suicide. His widow, Kathleen A. Shefchuk was appointed Executrix of his estate by the Probate Court of Geauga County, the Ohio county in which Gregory Shefchuk had resided.

Ultimately, numerous suits were filed in Ohio state and federal courts and a number of NASDR arbitrations were filed. The Executrix was named a party. Essentially, all the suits alleged losses as a result of negligence and/or fraud of both Shefchuks or either of them. Many pleadings contained allegations in the alternative as both the theory of loss and the individual Shefchuk involved.

The Illinois Union policy provided coverage for defense costs, as well as for potential indemnity. Both Robert Shefchuk and Gregory Shefchuk's Estate, through their respective counsel, sought defense coverage, but Illinois Union refused to defend either. Rather, Illinois Union filed a comprehensive declaratory judgment action

in the United States District Court for the Northern District of Ohio, naming all its insureds and virtually every plaintiff who claimed investment losses in the twenty-five or so underlying actions.

Illinois Union, Money Concepts, and several financial institutions that were parties to the district court declaratory judgment action arranged a global settlement with all claimants in the underlying actions. As part of the settlement, all claimants released both Robert Shefchuk and Gregory Shefchuk's Executrix, and all the underlying actions containing allegations against them were dismissed with prejudice. There never were any adjudications of any sort of wrongdoing, or even negligence, by either of the Shefchuks.

After the settlement of the underlying cases, the claims of Robert Shefchuk and Gregory Shefchuk's Executrix for defense costs and for fees in the coverage litigation remained pending in the district court. Summary judgment proceedings were then had in district court, with the only real issue being whether the allegations of each of the various complaints contained matters that had been potentially within the coverage of Illinois Union's policy so as to obligate Illinois Union to pay defense costs.

The district court found that most of the pleadings in the underlying actions contained allegations that required Illinois Union to defend Robert Shefchuk and that made Illinois Union liable for the defense costs that he incurred.

However, although the allegations were in many cases the same as to Gregory Shefchuk's Executrix, and

based upon alleged actions and omissions by Gregory Shefchuk in the alternative to identical allegations as to Robert Shefchuk, the district court held that it was "undisputed" that Gregory Shefchuk intentionally defrauded clients in the underlying suits and that Illinois Union did not have any duty to defend Gregory Shefchuk's Estate against claims arising out of his alleged conduct. (App. 49(a)). Although **nothing** has ever been established factually, much less adjudicated, as to Gregory Shefchuk's actual conduct, the district court just assumed the truth of allegations, rather than analyzing the allegations of pleadings as to whether they invoked the insurer's broad duty to defend under the language of both the pleadings and the policy.

All of Illinois Union, Robert Shefchuk, and Gregory Shefchuk's Executrix appealed the district court's decision of September 7, 2001, to the United States Court of Appeals for the Sixth Circuit. All appeals were consolidated for argument and for records purposes. A single decision was entered "per curium" by a panel of the Sixth Circuit on August 17, 2004. (App. 1(a)). The decision found Robert Shefchuk to have insurance coverage for defense in one additional underlying action and otherwise affirmed the district court's ruling as to Illinois Union's coverage obligations for Robert Shefchuk.

As to Gregory Shefchuk's Estate, the Sixth Circuit Opinion stated that the district court was wrong in taking allegations of underlying complaints as fact to determine whether coverage for defense existed since "the district court technically failed to follow the requirement under Ohio law that the claims be reviewed to determine whether there was any set of facts in the complaint that could possibly have led to a finding of

coverage." (App. 22(a)). The Sixth Circuit panel also held that "[a]s a result, we would be justified in remanding to the district court for individualized findings." (*Id.*). Nonetheless, the Sixth Circuit stated that it would not remand, based upon its faulty recollection of the oral argument in the matter, which had occurred on December 2, 2003:

> However, at oral argument of this appeal, counsel for the estate, when asked which of the underlying actions should have survived summary judgment, was unable to give a satisfactory answer, responding "Perhaps the Meyers' case." Under these circumstances, we decline to order additional review. (*Id.*).

At oral argument, counsel for the Estate had made no such concession, which was readily verifiable since the Sixth Circuit records all arguments, and the tape recordings were available. Counsel for the Estate obtained the tapes and transcribed the pertinent parts into an affidavit made a part of a timely Petition for Panel Rehearing filed August 31, 2004. That remained pending for fifteen months until November 30, 2005, when the Sixth Circuit panel of judges issued an Order. (App. 57(a)). That Order stated that the Petition for Rehearing was denied, but it also stated: "the Opinion is also amended by deleting the last two sentences before the section titled 'Conclusion.'"

Thus, the Sixth Circuit struck from its Opinion the above-quoted sentences to the effect that counsel made a concession, and that, under those circumstances, it was declining to order additional review. As amended, the section of the Opinion dealing with the Estate then ended

with the statement that, as a result of the failure of the district court to follow Ohio law and analyze the allegations of the underlying complaints, "we would be justified in remanding to the district court for individualized findings." (App. 22(a)). However, the "Conclusion" portion of the Sixth Circuit's Opinion was not also amended to do that, and the Conclusion states that the district court is affirmed in all respects except with regard to Illinois Union's obligation to defend Robert Shefchuk in one additional case.[1] With its modification of the Opinion through the Order denying the Petition for Rehearing, the Sixth Circuit's Opinion concludes with a "Conclusion" (App. 22(a)) that is a non-sequitur to the amended body of the Opinion dealing with the Estate.

Accordingly, on December 12, 2005, the Executrix filed with the Sixth Circuit her "Motion of Defendant-Appellant Kathleen A. Shefchuk, Executrix (1) for Reconsideration, Clarification and/or Correction of Order of November 30, 2005, Denying Petition for Rehearing, but Amending Opinion of August 17, 2004, and/or (2) for Recall of Mandate and Correction or Clarification of Same to Conform to Amendment of Opinion." That Motion remains pending in the Sixth Circuit.

There is ample authority permitting motions such as the pending motion filed by Petitioner in the Sixth Circuit. Sixth Circuit Rule 27(g) expressly provides for a motion for reconsideration of any order. Additionally, numerous

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[1] Subsequent to the August 17, 2004, Decision of the Sixth Circuit, Robert Shefchuk and Illinois Union settled all issues between them in the district court. The only unresolved issues remaining are those between Illinois Union and the Estate's Executrix.

cases have held that federal courts, both the United State Supreme Court and Circuit Courts of Appeals, have inherent power to recall their mandates, without regard to time limits, to correct the results of their orders in somewhat similar circumstances. The most comprehensive discussion, often cited, is contained in *Greater Boston Television Corp. v. Federal Communications Comm.*, 463 F.2d 268 (5 Cir.1971). Reasons for the recall of a mandate were discussed by that court in subdivisions of its opinion entitled: "(b) correction of clerical mistakes and clarification of mandate and opinion," and "(e) need to revise unintended instruction to trial court that produces unjust result." Certainly, an instruction in a "Conclusion" that varies from the result as stated in the Opinion falls into both these categories.

The illogic of the Court of Appeals' failure to grant the pending motion, which does not extend the time for a petition for writ of certiorari to the United States of Supreme Court, perhaps rises to the level of justification for a writ of mandamus. However, the Supreme Court has held that writ of mandamus must "not be used as a substitute for the regular appeals process." *Cheney v. United States Court for the District of Columbia*, 542 U.S. 367, 381, 124 S.Ct. 2576, 2587 (2004).

Since only an actual petition for rehearing operates to stay the running of the time of filing a petition for writ of certiorari to the United States Supreme Court from a Circuit Court of Appeals, and since the extension granted by Justice Stevens is about to expire[2] without a ruling by

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2 The extension runs to April 29, 2006. On April 12, 2006, the Clerk of the Supreme Court, under an interpretation of S.Ct. R. 13.5 to the

the Sixth Circuit on the pending motion, it is necessary to proceed with this Petition for Writ of Certiorari.

REASONS FOR GRANTING THE PETITION

There are two principal, overall reasons for granting this Petition for Writ of Certiorari.

First, the Court of Appeals' disposition on the case flatly contradicts its determination of the merits of the case as to the Executrix and the Estate. Such a disposition is inconsistent with any rational system of justice.

Second, the Court of Appeals' disposition of the matter provides the opportunity for an examination of what may be an extreme example of "judicial activism" and of the issuance of "unpublished opinions."

I. Even though the vast majority of the decisions of the Courts of Appeals are "unreported", it is of critical importance to the nation's system of justice and the "rule of law" that all federal appellate decisions be based upon some legal analysis and embody a disposition consistent with that analysis.

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effect that it permits only a single sixty day extension, even in a case such as this where the process could be avoided with a corrected Order by the Court of Appeals, returned unfiled to counsel for the Executrix a second application for a sixty day extension addressed to Justice Stevens.

A. Federal courts are required to dispose of cases consistent with their determination of the law.

S.Ct. R. 10(a) provides as an express reason for the United States Supreme Court to consider the granting of a Writ of Certiorari that a United States Court of Appeals "has so far departed from the accepted and usual course of judicial proceedings... as to call for an exercise of this Court's supervisory power."

Under 28 U.S.C. § 2106, appellate courts must make rulings and direct further proceedings "as may be just under the circumstances." Likewise, the oath of office prescribed by 28 U.S.C. § 453 for all federal judges and justices requires judges "to administer justice without respect to persons" and to "faithfully and impartially discharge all duties."

Whether by inadvertence or intent, these fundamental principles, essential to the integrity of the federal court system and the concept of the rule of law, are called into question when a federal appellate court's ultimate direction to the district court is inconsistent with the appellate court's own statement of the result required by application of the law to the record before the appellate court.

B. This case involves extremely timely issues relating to "unpublished" opinions and "judicial activism."

The Committee on Rules of Practice and Procedure of the Judicial Conference of the United States in a revised Memorandum on October 7, 2005

(http:\\www.uscourt.gov\rules\Reports\AP10-2005) proposed a new Federal Rule of Appellate Procedure 32.1. This will provide a uniform rule for the effect and usage of opinions designated by Courts of Appeals as "unpublished" or some similar designation. Effective January 1, 2007, an appellate court "may not prohibit or restrict the citation of federal judicial opinions, orders, judgments, or other written disposition that have been: (i) designated as 'unpublished . . .' "

The April 2006 ABA Journal E-report (http\\www.abanet.org\journal\e-eports\a21.punpub.html) contains an article by Molly McDonough entitled "Door Slowly Opens for Unpublished Opinions." It contains the statement:

> Unpublished opinions, often written by staff attorneys or law clerks were developed in the 1970s as a space- and mind-saving device for the federal appellate courts to dispense with some 80% of their cases. Critics have said that if these cases were citable, judges would have to spend more of their time and already overburdened resources crafting them.

The federal statutes essentially recognize a fundamental right in litigants to receive from the courts some minimal craftsmanship, some minimal coherency, and some minimal consistency between the analysis of the matter and the ordered result, whether designated "for publication" or "not for publication." A disposition that is a nonsequitur to the body of the opinion should not be allowed to be issued, and, if issued, should not be allowed to stand.

The term "judicial activism" is in vogue, frequently used by both commentators and by politicians. The term is used both favorably and as a criticism, with no uniform meaning or definition. A comment by Keenan D. Kmiec, "The Origin and Current Meaning of Judicial Activism", 92 Cal. L. Rev. 1441 (2004), is often cited. The fifth and final definition or type of "judicial activism" reviewed by Mr. Kmiec is "result-oriented judging." The author states that:

> Judicial activism [of this type] is not always easily detected, because the critical elements of judicial activism, either are subjective or defy clear and concrete definition. There is rarely smoking gun evidence of an ulterior motive, and it would be exceedingly difficult to "establish a non-controversial benchmark by which to evaluate how far from the 'correct' decision the supposedly activist judge has strayed." *Id.* at 1476.

In this case, a panel of judges of the Sixth Circuit may have simply wished to impose a result: the Executrix is to be denied her contractual coverage rights under Ohio law. That would be extreme result-oriented "judicial activism."

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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(any footnotes trail end of each document)
NOS. 02-3698/3767/3714
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

ILLINOIS UNION INSURANCE COMPANY,
Plaintiff-Appellant/Cross-Appellee,

v.

ROBERT C.SHEFCHUK,
Defendant-Appellee/Cross-Appellant,

ILLINOIS UNION INSURANCE COMPANY,
Plaintiff-Appellee,

v.

KATHLEEN A. SHEFCHUK, as Executrix of the Estate of Gregory D. Shefchuk,
Defendant-Appellant.

August 17, 2004, Filed

NOTICE: NOT RECOMMENDED FOR FULL-TEXT PUBLICATION. Sixth Circuit Rule 28(g) limits citation to specific situations. Please see Rule 28(g) before citing in a proceeding in a court in the Sixth Circuit If cited, a copy must be served on other parties and the Court. This notice is to be prominently displayed if this decision is reproduced.

JUDGES: BEFORE: SILER, DAUGHTREY, and GIBBONS, Circuit Judges.

OPINION BY: SILER, DAUGHTREY, and GIBBONS

OPINION: PER CURIAM. These three appeals result from litigation involving similar professional liability policies issued by and to the same parties, and they raise similar issues regarding the duty of the plaintiff, Illinois Union Insurance Company, to defend Robert Shefchuk and the estate of his son, Gregory Shefchuk, in various individual actions alleging the loss of thousands of dollars in investments due to the negligence and/or the misdeeds of the Shefchuks in their capacity as financial advisers. In the first appeal, Illinois Union challenges the district court's grant of partial summary judgment to defendant Robert Shefchuk, holding that Illinois Union had a duty to defend in ten of the underlying actions. In the second, Robert Shefchuk cross-appeals, arguing that the district court should have found a duty to defend in an additional action. In the third and last appeal, Gregory Shefchuk's estate challenges the court's grant of summary judgment to Illinois Union, arguing that the court erred in holding that the plaintiff had no duty under the policy to the estate in the underlying actions.

We conclude that the district court's resolution of the issues now before us was largely correct and affirm on all but one ruling.

FACTUAL AND PROCEDURAL BACKGROUND

In 1997, Illinois Union issued professional liability policies to Money Concepts Capital Corporation and its affiliate, RCS Financial Services. Covered as "insureds" under these policies were Robert Shefchuk and his son, Gregory Shefchuk, who were registered

representatives of Money Concepts, a financial services brokerage firm, and shareholders in RCS Financial Services, an investments advisory firm. Beginning in April 1998, some two dozen lawsuits were filed and arbitrations initiated against the Shefchuks. Money Concepts, and RCS Financial Services. The common thread in these underlying actions was a series of allegations that clients of the Shefchuks had lost their investments through the Shefchuks' negligence or fraud or both. In May 1998, a month after the allegations of fraud and mismanagement came to light, Gregory Shefchuk committed suicide. A few months later, RCS Financial Services declared bankruptcy.

When, in response to the individual lawsuits, Robert Shefchuk and Gregory Shefchuk's estate sought coverage under the Illinois Union policies, Illinois Union filed this action in federal court, seeking a declaratory judgment that it had no duty to defend or indemnify either Robert Shefchuk or his son's estate under the policy issued to RCS Financial Services and, alternatively, requesting rescission of the policy, on the ground that Gregory Shefchuk had concealed existing and potential claims against him when he applied for the policy. Robert Shefchuk counter-claimed, alleging that Illinois Union had breached the terms of its contracts when it failed to defend him in the underlying actions, as required by the policy issued to RCS Financial Services and by a second policy issued to Money Concepts.

The "broker-dealer financial services professional liability insurance policy" issued to Money Concepts -- the specific policy at issue in this case -- covered actions for "wrongful acts" committed by the named insured

and its representatives. "Wrongful act" was defined in the policy as "any negligent breach of duty, error, misstatement, misrepresentation, omission, 'publication injury' or other negligent act done or attempted by an insured, or by any person for whose acts the insured is legally responsible." The policy covered each individually named registered representative of the named insured for actions "arising out of or in the course and scope of his/her duties as a 'registered representative.'" The policy also contained a number of exclusions. Among those considered by the district court were the following:

B. Dishonesty Or Fraud/Personal Advantage/Non Public Information. We do not cover claims which arise out of or are contributed to by a "wrongful act" that is committed by or at the direction of an insured and which is dishonest, fraudulent, criminal, malicious or knowingly wrongful. We do not cover claims arising out of the insured gaining any personal profit or advantage to which the insured was not legally entitled. . . .

D. Violation Of Laws, Orders, Or Regulations. We do not cover claims which arise out of a willful violation of any laws, orders, rules or regulations of the United States, or any state, commonwealth, territory, county, subdivision or municipality thereof committed by or at the direction of an insured. . . .

R. Prior Acts/Unnamed Financial Services Professionals Or Registered Representatives. We do not cover claims arising out of: any "wrongful act", or series of "interrelated wrongful acts", of an insured occurring, or the first of which occurred, prior to the insured's "retroactive date": or out of "wrongful act" or

series of "interrelated wrongful acts" with respect to which a "written claim" has previously been presented to us under any predecessor policy. We do not cover "written claims" against an insured which arise out of any "wrongful act" or "interrelated wrongful acts" occurring, or the first of which occurred, prior to the effective date of coverage for said insured under this policy, or any predecessor policy issued by us, if the insured knew or should have known, by consulting his/her/its records or otherwise, that said act, error or omission was likely to result in a claim against the insured. . . .

The policy also included a claims exclusion endorsement that excluded coverage for claims "arising out of . . . any incident or fact situation which occurred prior to the effective date of this policy, which is known to an insured, and which may reasonably be expected to result in a claim or suit against an insured." In addition, the policy included the following severability clause:

More than one person or organization has been named as an insured on this policy. The inclusion of multiple insureds will not affect the rights of any such persons or organizations to be protected by this policy. We will cover each such person or organization just as if a separate policy had been issued to each. However, the inclusion of multiple insureds on this policy will not increase our liability beyond the Limits of Liability. . . .

In disposing of the motions for summary judgment filed by the parties in the action involving Robert Shefchuk, the district court applied Ohio law and separated the underlying actions into three categories: (1) cases that alleged knowing or intentional wrongdoing by Robert

Shefchuk or negligence that arose out of such conduct, (2) cases in which it was not clear whether the plaintiff was alleging negligence or an intentional tort on the part of Robert Shefchuk, and (3) cases that alleged negligence on the part of Robert Shefchuk that did not arise out of his wrongful acts. The court held that Illinois Union had no duty to defend Robert Shefchuk in the first category, finding that some of the cases were excluded by the "prior occurrence" exclusion and that others were barred by the second sentence of the "dishonesty" exclusion, involving actions taken for personal gain. The court held that Illinois Union did have to defend Robert Shefchuk in the second and third categories of cases. The parties later stipulated that, as of October 3, 2001, Robert Shefchuk had incurred $ 237,454.25 in defending the claims against which Illinois Union was found to have a duty to defend and prosecuting his claim against Illinois Union for coverage. The district court entered a final judgment in favor of Illinois Union on five of the underlying actions and in favor of Robert Shefchuk on ten of them.

As to the estate of Gregory Shefchuk, the district court held that Illinois Union had no duty to defend under the policy at issue. Noting that "it is undisputed that Gregory Shefchuk intentionally defrauded his clients through forged withdrawal slips and fraudulent account reports, thereby stealing funds which were not legally his," the court found applicable the exclusion barring coverage for claims "arising out of the insured gaining any personal profit or advantage to which the insured was not legally entitled." It then held that Illinois Union did not have a duty to defend the estate in the underlying actions alleging negligence against the estate because the negligence claims were dependent

upon Gregory Shefchuk's excluded acts of unlawful personal profit. As a result, the district court entered final judgment against Kathleen Shefchuk, representing her husband's estate.

Because all of the underlying actions have been settled, the only remaining question concerns Illinois Union's duty to defend. Appealing the district court's order as to Robert Shefchuk, Illinois Union argues, first, that California law, rather than Ohio law, should have been applied to the contract. It also contends that the district court found ambiguities in the contract that were not there, giving the court an excuse to interpret the contract against the insurance company. In particular, Illinois Union claims that the term "an insured" in the exclusions should have been read to refer to any insured under the contract, so that, for example, the dishonesty exclusion would have applied to all claims against Robert Shefchuk -- including even the claims of negligence against Robert Shefchuk -- because they could be traced back to the dishonest acts of Gregory Shefchuk, who was also insured under the policy. Illinois Union further argues that the first sentence of the dishonesty exclusion should not have been held unenforceable. In his cross-appeal, Robert Shefchuk contends that the district court was wrong in finding that there was no independent claim of negligence in the Savarino suit, which was one of the underlying actions placed by the court in the first category. Finally, the estate of Gregory Shefchuk contends that the district court erred in holding that Illinois Union had no duty to defend Gregory Shefchuk's estate under the policy, because Illinois Union had failed to adduce admissible proof on the record to establish that Gregory

Shefchuk had intentionally defrauded his clients as found by the district court.

ANALYSIS

I. Choice of Law

The first question faced by the district court involved a choice-of-law issue raised by Illinois Union, which asserted that the court should apply California law in interpreting the policy issued to Money Concepts, based on a provision entitled "Disputes With Us/Arbitration" that contained the following language:
By accepting the coverage provided by this policy, the insured agrees to be bound by the following arbitration rules in the event that a dispute arises between the insured and us with respect to coverage, liability for premiums or "deductibles," any term or condition of this policy, or any other matter arising out of the relationship between us and the insured or his/her/its representatives. . . .

2. In the event of any such dispute, the matter shall be resolved by binding arbitration before three privately selected arbitrators acting pursuant to the arbitration provisions of the California Arbitration Act, Sections 1280 through 1294.2 of the Code of Civil Procedure. . . .

3. The arbitrators shall apply the law of the State of California. . . .

5. If any party seeks to avoid these arbitration provisions, and any court shall be asked by either party to make any order concerning any dispute or

controversy in any way concerning the matters set forth above, the parties agree that the court shall apply California law. The parties also agree to request the court to abate any such proceeding pending transfer to the courts of California for determination of the validity of these arbitration provisions.

Illinois Union argues that the language in this provision is a general choice-of-law clause, contending that the term "matters set forth above" refers to the topics set out at the beginning of the provision: "disputes . . . with respect to coverage, liability for premiums or 'deductibles', any term or condition of this policy. . . ." Any other interpretation, it argues, would render the second sentence of provision five extraneous. Under this reading, two things would happen in the event of a suit against Illinois Union: (1) the court considering the case would have to apply California law, and (2) the parties would be required to request that the case be transferred to California for a determination of whether arbitration should be compelled.

Robert Shefchuk, on the other hand, argues that the provision is not a general choice-of-law provision, but rather only a requirement that California law be applied in deciding arbitrability issues. Under this reading, the term "matters set forth above" would refer only to the arbitration procedures outlined within the arbitration provision, not to all disputes that could arise under the policy.

The district court noted that this provision in the policy "does not contemplate that a dispute would be litigated in court rather than in arbitration" and "specifically provides that 'the arbitrators' shall apply California

law." But the court had already held that Illinois Union waived the right to enforce the arbitration clause when it initiated the federal action. Given its conclusion that the choice-of-law provision applied only to arbitration, the district court therefore chose to apply Ohio law to the merits of the claims before it. We conclude that this decision was correct and, therefore, turn to the substantive issues raised on appeal.

II. Interpretation of the Policy

We review a grant of summary judgment *de novo*. Under Ohio law, the question, raised by these appeals, of whether a policy provision is ambiguous is a question of law that is also reviewed *de novo*. *See GenCorp, Inc. v. Am. Int'l Underwriters, 178 F.3d 804, 818-19 (6th Cir. 1999)*.

Ohio law provides that "when a complaint against an insured states both negligence and intentional tort claims that are based upon the same occurrence, the insurance company that is contractually obligated to defend the insured in negligence actions is required to make a defense as to both claims against the insured, regardless of the ultimate outcome of the action or the insurance company's ultimate liability to the insured." *Preferred Mut. Ins. Co. v. Thompson, 23 Ohio St. 3d 78, 23 Ohio B. 208, 491 N.E.2d 688, 690 (Ohio 1986)*. Thus, if any one of the claims in an underlying action is covered under the policy, Illinois Union has a duty under Ohio law to defend Robert Shefchuk or the estate in that entire case, as long as all the claims in the case were based on the same occurrence, even though the case might also include claims that were not covered under the policy. Ohio contract law also requires that a

promise by an insurance company to defend against groundless, false, or fraudulent allegations -- as the Money Concepts policy does in this case -- obligates the insurance company to "assume the defense of the action where the underlying tort complaint states a claim which is potentially or arguably within the policy coverage." *Sanderson v. Ohio Edison Co., 69 Ohio St. 3d 582, 1994 Ohio 379, 635 N.E.2d 19, 23 (Ohio 1994).* In addition, under Ohio law, "an exclusion in an insurance policy will be interpreted as applying only to that which is *clearly* intended to be excluded." *Hybud Equip. Corp. v. Sphere Drake Ins. Co., 64 Ohio St. 3d 657, 597 N.E.2d 1096, 1102 (Ohio 1992).*

Finally, Ohio law requires that "words and phrases used in an insurance policy . . . be given their natural and commonly accepted meaning, where they in fact possess such meaning, to the end that a reasonable interpretation of the insurance contract consistent with the apparent object and plain intent of the parties may be determined." *Gomolka v. State Auto. Mut. Ins. Co., 70 Ohio St. 2d 166, 436 N.E.2d 1347, 1348 (Ohio 1982).* When a term in a policy is open to multiple possible interpretations, the contract is construed against the insurer. *See King v. Nationwide Ins. Co., 35 Ohio St. 3d 208, 519 N.E.2d 1380, 1383 (Ohio 1988).*

A. The Dishonesty Exclusion

Reading the policy as a whole, the district court found that the first sentence of the dishonesty exclusion was "meaningless or illogical." As noted above, that provision barred coverage of claims "which arise out of or are contributed to by a 'wrongful act' that is committed by or at the discretion of an insured and

which is dishonest, fraudulent, criminal, malicious, or knowingly wrongful." But, as we also noted, in another section the policy defines "wrongful act" as a "*negligent* breach of duty, error, misstatement, omission, 'publication injury' or *other negligent act*". (Emphasis added.) The district court therefore interpreted the initial sentence of the dishonesty exclusion to bar coverage of claims arising out of acts that are *both* negligent *and* deliberate or non-negligent, *i.e.*, "dishonest, fraudulent, criminal, malicious, or knowingly wrongful." Noting that "dishonest, fraudulent, or criminal acts are inherently more than negligent," the district court ruled that because "the clause excludes only claims that are both negligent and not negligent," its "logical incoherence renders the first sentence of the clause unenforceable."

As a result, the district court enforced the exclusion clause against the Shefchuks only as far as the claims were excluded by the second sentence of the clause, *i.e.*, that "subset of dishonest, fraudulent, or criminal acts in which the actor acts so as to profit personally from his misdeeds." The court noted, "One can imagine dishonest acts that do not come within this definition," and hypothesized a situation in which "Gregory Shefchuk persuaded his father to guarantee forged signatures so that he (Gregory) could profit." If the father did so for reasons other than his own personal gain, the court posited, "the claim against Robert Shefchuk would not come within the second sentence of the exclusion clause, although it would come within the first, unenforceable, sentence of the clause."

Without doubt, the culprit in this case is poor drafting. It is not difficult to discern what the insurance company

probably *meant* to do when it drafted the coverage and exclusion provisions in this policy -- to insure against negligent acts but not dishonest, fraudulent, or illegal acts or those intended to result in personal gain. As simple as this should be in terms of clear English exposition, that is not what the contract actually says. Hence, if the first sentence of the dishonesty exclusion is not unenforceable because illogical, when it is read together with other provisions in the policy, it certainly creates an ambiguity.

Whether viewed as illogical or ambiguous, the result in interpretation is virtually the same. Because insurance policy exclusions apply only to what is *clearly* intended to be excluded, *Hybud Equip. Corp., 597 N.E.2d at 1102*, and because ambiguities in insurance contracts are construed against the insurer, *King, 519 N.E.2d at 1383*, Illinois Union cannot avoid its duty to defend the claims in the underlying actions on the ground that some of those claims appear to arise out of knowingly wrongful acts, because such acts, by definition, are not negligent.

B. Meaning of "An Insured"

Illinois Union's next avenue of attack comes in the interpretation of the term "an insured" in the exclusion clauses. Arguing that the term is synonymous with "any insured," Illinois Union asks us to conclude that none of the underlying actions against either Robert Shefchuk or the estate are covered under the policy because all of them "arise out of" the clearly excluded wrongful conduct of Gregory Shefchuk, who was "an insured" under the contract. Robert Shefchuk, on the other hand, argues that the term "an insured" in the policy

can mean the same thing as "the insured," depending upon the context in which it is used. Under his reading, the exclusion clause would apply only if the excluded conduct was undertaken by the insured seeking coverage, *i.e.*, by Robert Shefchuk himself.

The contract provides that every registered representative is "an insured" under the policy, "but only for liability arising out of or in the course and scope of his/her duties." Under this definition, assuming that Gregory Shefchuk was acting within the course of his duties (an issue contested by Robert Shefchuk), Gregory Shefchuk was "an insured" under the policy. Illinois Union takes the position that excluded acts by Gregory Shefchuk therefore bar coverage of all insureds under the policy: It contends that the simple meaning of the word "an," as opposed to "the," supports this conclusion, quoting *Allstate Ins. Co. v. Foster, 693 F. Supp. 886, 889 (D. Nev. 1988)* (citing Black's Law Dictionary, 1, 1324 (5th ed. 1979)), for the explanation that "['a'] or 'an' is an indefinite article often used in the sense of 'any' and applied to more than one individual object; whereas 'the' is an article which particularizes the subject spoken of." Illinois Union urges us to interpret the contract using these accepted definitions -- under Ohio law, terms in insurance contracts must be given their plain and ordinary meaning, *see Penn Traffic Co. v. AIU Ins. Co., 99 Ohio St. 3d 227, 2003 Ohio 3373, 790 N.E.2d 1199, 1202 (Ohio 2003)* -- and to hold that the term "the insured" refers to a particular insured, such as the person claiming coverage, while "an insured" refers to any one of the insureds under the policy.

In some cases, courts considering the meaning of "an insured' in insurance contract exclusions have held that the exclusions apply if any co-insured under the contract engages in the excluded conduct.[1] In this case, however, the issue is complicated by the policy's severability clause. As noted above, the policy contains a "multiple insureds" provision that states, in part: "The inclusion of multiple insureds will not affect the rights of any such persons or organizations to be protected by this policy. We will cover each such person or organization just as if a separate policy had been issued to each." Courts considering similar provisions have split over whether such a severability clause makes the term "an insured" ambiguous.[2] Those that have found ambiguity have been unable to reconcile a reading of the term "an insured" that denies coverage to people based on the actions of their co-insureds with a clause specifying that coverage is separate for each insured. As the Wisconsin Court of Appeals wrote in *Nemetz, 135 Wis. 2d 245, 400 N.W.2d 33, 38 (Wis. Ct. App. 1986)*: "We conclude that this contract is ambiguous because the severability clause creates a reasonable expectation that each insured's interests are separately covered, while the exclusion clause attempts to exclude coverage for both caused by the act of only one."

Although we recognize that the question is a close one, we conclude that in this case the severability clause in the Illinois Union policy makes the term "an insured" ambiguous. In the cases in which the courts have found to the contrary, the severability clauses in the disputed policies have tended to provide generally that "the insurance applies separately to each insured." The clause in the Illinois Union policy, on the other hand, includes an additional provision: "We will cover each

such person or organization just as if a separate policy had been issued to each." There is no way we can see to reconcile a provision this explicit with the assertion that the exclusions bar coverage of claims arising out of the excluded acts of anyone listed as "an insured" under the policy. If, under the Illinois Union policy, the actions of one insured can preclude another insured from coverage, then the two are not being treated as though a separate policy had been issued to each of them. Under the particular facts of this case, we find no error in the district court's determination that the provisions in question created an ambiguity that must be resolved in the insured's favor.

We conclude that the same is true with regard to the insurance company's argument that the claims-exclusion endorsement bars coverage here, as well as its contention that even the negligence claims against Robert Shefchuk are barred because each of the exclusion clauses has language excluding claims that "arise out of" excluded conduct by "an insured." We reach this conclusion despite the fact that it appears, superficially at least, to equate the terms "*an* insured" and "*the* insured," a result that Illinois Union contends is simply not possible, given the universal understanding of the difference between "an" (the indefinite article meaning "any") and "the" (the definite article) in common English usage. Again we point to drafting as the source of the difficulty here. For example, the dishonesty exclusion that is at the heart of the dispute in this case uses the term "an insured" in its first sentence, the term "the insured" in its second sentence, and the term "any insured" in its third and last sentence, which bars coverage of insider-trading. If these phrases were not meant' to be used

interchangeably, the contract should have made the distinctions clear.

III. Specific Claims

On appeal, the parties insist that the district court mischaracterized various of the underlying actions. In particular, Illinois Union contends that it should not have to defend Robert Shefchuk in the *Meyer* and *Bradler* actions, arguing that the complaints in those cases alleged only intentional torts and negligence that arose from those intentional torts. Robert Shefchuk, in return, claims that the district court should have found a duty to defend in the *Savarino* action, asserting that the *Savarino* action includes negligence claims separate and apart from the intentional tort claims.

As a preliminary matter, we reject the argument advanced by both Robert Shefchuk and the estate that the exclusionary clauses in the Illinois Union policy do not come into effect unless the excluded acts relied upon by the insurer to deny coverage are actually proven, rather than merely alleged in the underlying actions. Robert Shefchuk points to language in the claims exclusion endorsement, for example, that bars coverage for an act that "occurred" before the policy's effective date and was "known" to an insured. The term "occurred," he argues, means an event that actually happened. In contrast, some of the other exclusions in the policy -- ones that are not otherwise relevant here -- use the term "actual or alleged."

We think the answer to this purported interpretation is found in Ohio case law governing an insurer's promise to defend against groundless, false, or fraudulent allegations, as is the case with the Illinois Union policy.

Under that law, "the test of the duty of an insurance company . . . to defend an action against an insured, is the scope of the allegations of the complaint in the action against the insured," Motorists Mutual Ins. Co. v. Trainor, 33 Ohio St. 2d 41, 294 N.E.2d 874, 875 (Ohio 1973) (syllabus), even though the "'scope of the allegations' may encompass matters well outside the four corners of the pleadings." City of Willoughby Hills v. Cincinnati Ins. Co., 9 Ohio St. 3d 177, 9 Ohio B. 463, 459 N.E.2d 555, 558 (Ohio 1984). Thus, a court deciding whether an underlying action is covered by an insurance policy is required to determine, by looking at the scope of the allegations, whether they "state a claim which is potentially or arguably within the policy coverage." *Id.* In other words, the duty to defend is linked to the duty to indemnify, and the duty to defend arises only when the allegations potentially state a claim that is within the policy's coverage. This interpretation is supported by the language of the policy at hand, in which the duty to defend is limited to suits which "seek [] 'damages' which are payable under the terms of this policy."

If the duty to defend arises only when the allegations potentially state a claim that is within the policy's coverage, it follows that there is no duty to defend when there is no possibility that the insurance company will have to pay damages. The question thus becomes whether, in the underlying actions at issue, there was a potential that the insurance company would have to pay damages. If there was such a possibility, then the allegations stated a claim that was potentially within the policy's coverage; if there was no such possibility, the allegations did not state a claim potentially within the policy's coverage and there was no duty to defend.

We thus turn to a review of the individual claims over which there remains a dispute on appeal in order to determine, not whether the facts that would exclude coverage have actually been shown, but whether the allegations present a claim potentially within the coverage of the policy and thus impose a duty to defend.

A. The Meyer Claim

Illinois Union objects to the district court finding that it had a duty to defend in *Meyer v. Shefchuk*, Case No. 98M169 (Geauga County Ct. Comm. Pleas). In that action, Robert and Judith Meyer alleged that Robert Shefchuk told them he would invest their money in "safe, conservative, diversified and suitable investments which would generate a yield of at least 13%." In reliance upon those representations, Robert Meyer took retirement under a plan that provided a lump sum payment of $ 360,000 which the couple then invested with the Shefchuks. According to the complaint, Robert Shefchuk invested the sum in illiquid and highly speculative investments that included large up-front commissions and fees from which he benefitted, charged the Meyers with additional undisclosed commissions and fees, misrepresented to the Meyers the net value of their portfolio, and failed to disclose to them that the distributions they were receiving were made largely from principal, not income, despite the fact that the Meyers had told Shefchuk not to make distributions from the principal. Throughout, Shefchuk "repeatedly reassured [the Meyers] that his recommended investment portfolio was operating profitably and in accord with their original expressed goals." The Meyers sued the Shefchuks, RCS Financial Services, Money Concepts; and International Financial

Services Capital Corporation for fraud and misrepresentation, breach of fiduciary duty, breach of express and implied contract, and negligence. The negligence claim reads:

Defendants had a duty to investigate and determine the financial sophistication, needs and goals of the Meyers and to recommend and invest only in securities which were suitable to their expressed and apparent needs and goals. Defendants breached this duty to "know your customer" by investing in unsuitable, illiquid and high risk ventures which were totally inappropriate to the Meyers investment needs. . . . Defendants' actions did not meet the standard of care required of their profession under the circumstances.

We are satisfied that however groundless this allegation might have turned out to be, it stated a claim for negligence that required Illinois Union to defend on the insured's behalf.

B. The Bradler Claim

Gary and Marleen Bradler brought claims against American Skandia, Money Concepts, Kathleen Shefchuk as Executrix of the Estate of Gregory Shefchuk, Robert Shefchuk, and a number of banks claiming, in count two, that American Skandia was "presented with an unauthorized request for withdrawal from Defendant Gregory Shefchuk and/or Defendant Money Concepts and/or Robert Shefchuk" that contained Gary Bradler's forged signature, and that the "forged signature was guaranteed by Defendants, Robert Shefchuk and Money Concepts." The district court found that it was unclear whether the

complaint claimed an intentional tort against Robert Shefchuk or just that he had negligently guaranteed a signature. Again, although the claim might ultimately have proven groundless, we agree and find a duty to defend here, given that the claim is potentially within the policy's coverage.

C. The Savarino Claim

Robert Shefchuk asserts that the district court erred in finding that Illinois Union did not have to defend him in *Savarino v. Shefchuk*, Case No. 99P528 (Geauga County Ct. Comm. Pleas). That action alleged that James Savarino had tendered $ 30,000 to Robert Shefchuk for him to invest, but that Shefchuk neglected to invest the money or report to Savarino on the state of the account. The complaint was entitled a "complaint for negligence" and alleged, in part, that "defendant has failed to invest, has negligently managed, or has otherwise absconded with Plaintiff's $ 30,000."

Contrary to the district court's ruling, we conclude that the *Savarino* complaint potentially states a claim that is within the policy's coverage. It is not a situation, like that described by the district court, in which a contract claim is mislabeled as a negligence claim and there is no possibility that the claim will end up being under the policy's coverage. Rather, in this situation, Savarino apparently did not know what happened to his money, just that he gave it to Robert Shefchuk to invest and that Shefchuk did not invest it. Though the facts set out in the complaint, if proved, might tend to lead to the conclusion that Shefchuk engaged in intentional wrongdoing, it is also possible that the failure to invest occurred through negligence and, if that is the case, the

claim would have been covered by the insurance policy. On this portion of the judgment, we conclude that the insurance company had a duty to defend, and we therefore find it necessary to reverse the district court's order granting summary judgment in Illinois Union's favor.

D. The Claims Against Gregory Shefchuk's Estate

In taking the allegations of the complaints filed against the estate as fact and determining whether coverage existed based on those facts, the district court technically failed to follow the requirement under Ohio law that the claims be reviewed to determine whether there was any set of facts in the complaint that could possibly have led to a finding of coverage. *See Cole v. Am. Indus. & Res. Corp., 128 Ohio App. 3d 546, 715 N.E.2d 1179, 1184 (Ohio Ct. App. 1998)* ("This test provides that if there is no set of facts alleged in the complaint against an insured which, if proven true, would result in the insurance company's duty to pay damages, then the insurance company need not provide a defense.") As a result, we would be justified in remanding to the district court for individualized findings. However, at oral argument of this appeal, counsel for the estate, when asked which of the underlying actions should have survived summary judgment, was unable to give a satisfactory answer, responding, "Perhaps the Meyers' case." Under these circumstances, we decline to order additional review.

CONCLUSION

For the reasons set out above, we conclude that the district court's judgment should be AFFIRMED in all

respects except with regard to the ruling on Illinois Union's obligation to defend in the underlying action filed against Robert Shefchuk by James Savarino. As to that portion of the district court's decision, the judgment is REVERSED and the case is REMANDED for further proceedings in conformity with this opinion.

- ---------- Footnotes ----------

n1 *See, e.g., Allstate, 693 F. Supp. at 889* ("Since [the policy] excludes coverage for harm resulting from the intentional or criminal 'acts of *an* insured person,' the insurance policy excludes coverage to any other insureds . . . for liability arising from the harm which is directly attributable to the intentional or criminal act."); *Allstate Ins. Co. v. Stamp, 134 N.H. 59, 588 A.2d 363, 365 (N.H. 1991)* ("We find that Allstate's use of the indefinite article 'an,' rather than the definite 'the,' before 'insured' is a clear reference to *any* insured who commits an intentional act resulting in damages, regardless of whether or not he is the particular insured seeking coverage."); *Farmers Ins. Co. of Washington v. Hembree, 54 Wn. App. 195, 773 P.2d 105, 108 (Wash. Ct. App. 1989)* ("Here, the exclusion is not restricted to intentional acts of the particular insured sought to be held liable, but broadly excludes coverage for all intentionally caused injury or damage by *an* insured, which includes anyone insured under the policy."); *Travelers Ins. Co. v. Blanchard, 431 So.2d 913, 915 (La. Ct. App. 1983)* ("The exclusion is not restricted to intentional acts of the particular insured sought to be held liable, but broadly excludes coverage for *all intentionally caused* injury or damage by *an insured person.*").

n2 *Compare, e.g., State Farm Fire & Cas. Ins. Co. v. Keegan, 209 F.3d 767, 771 (5th Cir. 2000)* (finding severability clause makes policy language ambiguous); *Catholic Diocese of Dodge City v. Raymer, 16 Kan. App. 2d 488, 825 P.2d 1144, 1151 (Kan. Ct. App. 1992)* (same): *Northwestern Nat. Ins. Co. v. Nemetz, 135 Wis. 2d 245, 400 N.W.2d 33, 38 (Wis. Ct. App. 1986)* (same), *with, e.g., Allstate Ins. Co. v. Kim, 121 F. Supp. 2d 1301, 1308 (D. Haw. 2000)* (stating that "the majority opinion holds, as does this Court, that a severability clause does not prevent an intentional acts exclusion from barring coverage for the alleged negligence of an intentional tortfeasor's coinsureds");*Mut. of Enumclaw Ins. Co. v. Cross , 103 Wn. App. 52, 10 P.3d 440, 445 (Wash.Ct. App. 2000)* (finding that severability clause did not make policy ambiguous); *Gorzen v. Westfield Ins. Co., 207 Mich. App. 575, 526 N.W. 2d 43, 45 (Mich. Ct. App. 1994)* (same); *United Ohio Ins. Co. v. Metzger, 1999 Ohio App. LEXIS 920, 1999 WL 84201 (Ohio Ct. App. Feb. 8, 1999)* (unreported decision) (using severability clause to find that wife was separately insured from husband under insurance policy but not mentioning clause in discussion of exclusion that used term "an insured").

Filed 9/7/01
Case No. 1:99CV2320
IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO EASTERN DIVISION

ILLINOIS UNION INSURANCE CO.,
Plaintiff,

vs.

RCS FINANCIAL, SERVICES, INC., et al.,
Defendants.

Judge Ann Aldrich

MEMORANDUM AND ORDER

This case is before the Court on the motions of Robert C. Shefchuk and the Estate of Gregory D. Shefchuk ("the Estate") for partial summary Judgment on their counterclaims against Illinois Union, and on Illinois Union's cross-motion for partial summary judgment against the counterclaims of Robert C. Shefchuk and the Estate. The counterclaims contain six counts. Both the motions and the cross motion seek summary judgment only on counts one and two. Count one of the counterclaim seeks a declaration that Illinois Union has a duty to defend Robert Shefchuk and the Estate in several lawsuits and arbitrations brought against them by investment clients (the "Underlying Actions"). Count two of the counterclaim seeks damages resulting from Illinois Union's alleged breach of its contractual duty to defend the Underlying Actions. For the following reasons, Robert Shefchuk's motion (docket no. 81) is

granted in part and denied in part, the Estate's motion (docket no. 124) is denied, and IIIinois Union's motion (docket no. 118) is granted in part and denied in part.

FACTS

A. The Shefchuks

Robert and Gregory Shefchuk, father and son, were employees of Money Concepts Capital Corp. Robert was registered with the National Association of Securities Dealers as the representative of Money Concepts pursuant to the Securities Exchange Act of 1934. He also was the designated principal of Money Concepts's Office of Supervisory Jurisdiction for the Northeast Ohio region pursuant to the rules of the NASD. Because he was a designated principal, Money Concepts gave him a signature stamp used to guarantee signatures pursuant to the Securities Transfer Act Medallion Program.

As designated principal in Northeast Ohio, Robert was responsible for supervising all of Money Concepts's registered representatives in the region, including his son, Gregory. While under this supervision, the younger Shefchuk allegedly forged his clients' signatures on withdrawal forms for the purpose of illicitly transferring money out of their investment accounts. Beginning in April 1998, clients of both Robert and Gregory began filing claims against them and Money Concepts, seeking recovery of the stolen funds. In May 1995, Gregory killed himself.[1]

B. The Money Concepts Policy

Money Concepts was insured by Illinois Union under a professional liability policy. Illinois Union issued policy no. CRL GI 8209573 (the "Money Concepts Policy") for a policy period of August 15, 1996 to August 15, 1997. Money Concepts renewed the policy for the period of August 15, 1997 to August 15, 1998. The policy contains a Registered Representatives Endorsement, retroactively covering both Gregory and Robert Shefchuk as follows:

(1) with respect to "wrongful acts" arising out of or in connection with their acts as investment advisers or "registered investment advisers," a retroactive date of August 15, 1995; and

(2) with respect to other "wrongful acts" for which there is coverage under the policy, a retroactive date of August 15, 1991.

The policy defines a "wrongful act" as:

any negligent breach or duty, error, misstatement, misrepresentation, omission, "publication injury" or other negligent act done or attempted by an insured, or by any person for whose acts the insured is legally responsible.

The policy also contains a duty to defend clause requiring Illinois Union,

as part of and subject to the applicable Limits of Liability hereunder, any "suit" brought against the insured because of a "wrongful" act to which this policy applies and which seeks "damages" which are payable under the terms of this policy, even if any of the

allegations of the "suit" are groundless, false, or fraudulent.[2]

C. The Money Concepts Policy—Exclusions

The Money Concepts Policy contains several exclusion clauses. The relevant clauses are as follows:

1. Fidelity bond exclusion. "We do not cover claims covered, in whole or in part, by an insured's fidelity bond(s)."

2. Dishonesty exclusion. "We do not cover claims which arise out of or are contributed to by a 'wrongful act" that is committed by or at the direction of an insured and which is dishonest, fraudulent, criminal, malicious, or knowingly wrongful. We do not cover claims arising out of the insured gaining any personal profit or advantage to which the insured was not legally entitled.

3. Illegality exclusion. "we do not cover claims which arise out of a willful violation of any of the laws, orders, rules, or regulations of the United States, or any state ... committed by or at the direction of an insured, or ratified by an insured."

4. Prior occurrence exclusion. "[T]here is no coverage under this policy for any claim arising out of ... any incident or fact situation which occurred prior to the effective date of the policy, which is known to an insured, and which may reasonably be expected to result in a claim or suit against an insured..."

D. The Money Concepts Policy--Choice of Law.

The Money Concepts Policy contains a choice of law provision within its arbitration clause. The clause provides, in pertinent part:

By accepting the coverage provided by this policy, the insured agrees to be bound by the following arbitration rules in the event that a dispute arises between the insured and us with respect to coverage, liability for premiums or "deductibles," any term or condition of this policy, or any other matter arising out of the relationship between us and the insured or his/her/its representatives.

***

2. In the event of any such dispute, the matter shall be resolved by binding arbitration before three privately selected arbitrators acting pursuant to the arbitration provisions of the California Arbitration Act...

3. The arbitrators shall apply the law of the State of California.

***

5. If any party seeks to avoid these arbitration provisions, and any court shall be asked by either party to make any order concerning any dispute or controversy in any way concerning the matters set forth above, the parties agree that the court shall apply California law.

SUMMARY JUDGMENT STANDARD

A party is entitled to summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment

as a matter of law." Fed. R. Civ. P. 56(c). The moving party bears the initial burden of demonstrating the absence of a genuine issue of material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 323-25 (1986). If the moving party meets this burden, the non-moving party "may not rest upon the mere allegations or denials of [its] pleading;" the burden shifts to the non-moving party to demonstrate the existence of a material dispute. "The nonmoving party, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). That is, the non-moving party must go beyond the pleadings and produce some evidendary support for its position. Celotex, 477 U.S. at 324.

The Court must view the evidence in the light most favorable to the non-moving party as it determines whether a genuine issue of material fact exists. Adickes v. S.H. Kress & Co., 398 U.S. 144, 157 (1970). A fact is material only if its resolution will affect the outcome of the lawsuit. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). The Court determines whether an issue is "genuine"' by considering the applicable evidentiary standards. Thus in most civil cases, the Court must decide whether the evidence is such that "reasonable jurors could find by a preponderance of the evidence that the [non-moving party] is entitled to a verdict" or whether, on the other hand, the evidence is "so onesided that the [moving party] must prevail as a matter of law."'Id. at 252. Rule 56(c) "mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which

that party will bear the burden of proof at trial." Celotex, 477 U.S. at 322.

CHOICE OF LAW

Before turning to the substantive questions presented by the cross-motions, the Court must determine which jurisdiction's law applies. Illinois Union argues that the Court's order of January 31, 2001, denying its motion to dismiss or stay the action pending arbitration requires the Court to apply California law to the counterclaim that is at issue in these cross-motions. The Court finds this argument unpersuasive. In the order of January 31, the Court applied California law because the parties, as indicated in paragraph 5 quoted above, had explicitly chosen California law to govern disputes in court concerning arbitrability.[3] At issue now is whether the parties have chosen California law to govern the substance of their dispute. Illinois Union argues that they have, presumably relying on paragraph 3 as quoted above. Shefchuk and the Estate argue that Ohio law applies.

On its face, the choice of law provision does not contemplate the possibility that a dispute would be litigated in court rather than in arbitration. It specifically provides that "the arbitrators" shall apply California law. Because the Court has only diversity jurisdiction in this case, it applies the choice of law rules of Ohio. Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496 (1941). Under Ohio law, an ambiguous insurance contract is interpreted contra proferentem. Travelers' Indem. Co. v. Reddick 37 Ohio St.2d 119, 121, 308 N.E.2d 454, 455-56 (1974). In this case, therefore, the Court interprets the choice of law to apply only in

arbitration. As the case is not in arbitration, the Court will ignore the clause and apply Ohio's default choice of law rules.

Under Ohio law, a contract is governed by the law o€ the jurisdiction with the most significant relationship to the contract. Babcock & Wilcox Co. v. Arkwright-Boston Mfg. Mut. Ins. Co., 867 F.Supp. 573, 577 (N.D. Ohio 1992) (citing National Union Fire Ins. v. Watts, 963 F.2d 148 (6th Cir.1992)). to determine which jurisdiction has the most significant relationship to the contract, Ohio law looks to the Restatement. Macurdy v. Sikov & Love, P.A., 894 F.2d 818, 821-22 (6th Cir.1990). Section 188 of the Restatement (Second) of Conflict of Laws describes the following factors as determinative of the state with the most significant relationship to the contract:

1. the place of contracting;
2. the place of negotiating the contract;
3. the place of performance;
4. the location of the subject matter of the contract; and
5. the domicile, residence, nationality, place of incorporation, and place of business of the parties.

Restatement (Second) of Conflict of Laws, §188, The factors "are to be evaluated according to their relative importance with respect to the particular issue." Id. In General Accident Ins. Co. v. Insurance Co. of N. Arm, 69 Ohio App-3d 52, 59-60, 59o N.E.2d 33,37-38 (1990), where an insurance contract did not specify the principal location of the insured risk but generally covered the insured for all its operations, and when the insured was based in Ohio, the court held that Ohio law

had the most significant relationship to the contract. The same reasoning applies here. Therefore, this Court finds that Ohio law governs the interpretation of the Money Concepts Policy.

PRINCIPLES OF INTERPRETATION

In interpreting the relevant exclusion clauses in the Money Concepts Policy, the Court is guided by the following principles:

A. Ohio Law Regarding The Duty To Defend

The duty to defend is broad, especially in cases such as this, in which the insurer undertakes to defend against false or fraudulent claims. The "test of the duty" of the insurer is "the scope of the allegations of the complaint in the action against the insured." Motorists Mut. Ins. Co. v. Trainor, 33 Ohio St.2d 41, syll. Par. 2, 294 N.E.2d 874 (1973).

This "scope of the allegations" rule must be interpreted carefully. The essential difficulty created by the rule is that it puts both the insurer and the insured at the mercy of the third party who sues the insured. This difficulty is especially great in cases such as this, in which there are many complaints filed by many third parties and drafted by many lawyers.

Ohio law takes this difficulty into account. The basic rule is that an insurer cannot altogether escape the duty to defend in cases in which it has agreed to defend against groundless, false, or fraudulent claims by pointing to facts outside the pleadings that would exclude the possibility of coverage. Erie Ins. Exch. v.

Colony Dev. Corp., 136 Ohio App.3d 419, 422-23, 736 N.E.2d 950-953 (2000). However, to avoid placing the insurer completely at the mercy of the third-party plaintiff, Ohio law provides that the insurer will be absolved of its duty if, after discovery, it can demonstrate that there is in fact no possibility of coverage, Helman v. Hartford Fire Ins. Co., 105 Ohio App.3d 617, 625, 664 N.E.2d 991, 996 (1995). While there do not appear to be any Ohio cases on point, another widely accepted principle protects insurers from poorly drafted pleadings. When the third party improperly labels his claim, the duty to defend will not attach even if the claim as labeled is within the coverage of the policy, when the claim, in reality, is excluded See, e.g., Prior v. South Carolina Med Malpractice Liab. Ins. Joint Underwriting Ass'n, 407 S.E.2d 655, 657 (S.C. Ct. App. 1991); Boston Symphony Orchestra, Inc. v. Commercial Union Ins. Co., 545 N.E.2d 1156,1159 (Mass. 1989); Lionel Freedman, Inc. v. Glens Falls Ins. Co., 267 N.E.2d 93, 95 (N.Y.1971). This rule is sensible insofar as it looks to substance rather than to form, this Court does not find that the Ohio Supreme Court would impose a duty to defend merely because the plaintiff in a breach of contract action, for example, also used the word "negligence" in his complaint. However, the rule cannot be interpreted too broadly. Even if most of the facts alleged in a complaint could not create a possibility of coverage under the policy, the duty to defend attaches if any claim within the complaint is even arguably or partially within the scope of coverage. Sanderson v. Ohio Edison Co., 69 Ohio St.3d 582, 586,635 N.E.2d 19, 23 (1994).

Ohio law also protects the insured from the vagaries of third party's pleadings. Again, the basic rule is that

courts look to the allegations of the complaint to determine whether the duty to defend attaches. But in some cases, "the pleadings alone may not provide sufficient factual information to determine whether the insurer has an obligation to defend the insured. ... [T]he `scope of the allegations' may encompass matters well outside the four corners of the pleadings." City of Willoughby Hills v. Cincinnati Ins. Co., 9 Ohio St.3d 177, 180, 459 N.E.2d 555, 558 (1984). The rationale for permitting courts to go beyond the four corners of the complaint is that, in a modern system of notice pleading, "the dimensions of a lawsuit are not determined by the pleadings, because the pleadings are not a rigid and unchangeable blueprint of the rights of the parties." Id at 179, 459 N.E.2d at 557 (citation and internal quotation marks omitted). As the New York Court of Appeals has observed:

[A]n insured's right to a defense should not depend solely on the allegations a third party chooses to put in the complaint. This is particularly so because the drafter of the pleading may be unaware of the true underlying facts or the nuances that may affect the defendant's coverage and it might not be in the insured"s (or the insurer's) interest to reveal them.

Fitzpatrick v. American Honda Motor Co., 575 N.E.2d 90, 94 (N.Y. 1991). As a result of these considerations, the insured is entitled to a defense from the insurer unless the claim is neither arguably nor partially within the policy's coverage. Sanderson v. Ohio Edison Co., 69 Ohio St.3d 582, 586, 635 N.E.2d 19, 23 (1994). Thus if the facts of a complaint arguably or partially could support a claim for negligence, for example, the insurer will

have a duty to defend even if the third party has pleaded his case solely in terms of breach of contract.

B. The Money Concepts Policy's Use of the Phrase "An Insured" Is Ambiguous, and the Phrase Must Be Interpreted As Synonymous with "The Insured."

As many courts in other jurisdictions have noted, the words "an insured" in an exclusion clause must be distinguished from the words "the insured," The former usually refers to any insured. The latter refers to the particular insured whose claims are to be excluded. See, e.g., Pink Cadillac Bar & Grill, Inc. v. United States Fid & Guar. Co., 925 P.2d 452,458 (Kan. Ct. App. 1997); Allstate Ins. Co. v. Smiley, 659 N.E.2d 1345,1352 (Ill. App. Ct.1996); Jaramillo v. Murcury In., Co, 494 N.W.2d 335, 341 (Neb.1993) (interpreting Califomia law).

In this case, Shefchuk persuasively argues that the policy uses the word "an insured" as a synonym for "the insured." Thus, he argues, the Court should not interpret "an insured" to mean any insured, as it usually would. The Court agrees that the policy is at least ambiguous with regard to the meaning of "an insured." For example, in Section VII, the policy provides that "if a `written claim' is made or 'suit' is brought against an insured, the insured must immediately send us every demand, notice, summons or other process relating to said claim" (emphasis supplied). Likewise, the policy excludes coverage for "any liability an insured assumes under any contract or agreement, whether written or oral; but [the exclusion] does not apply to liability the insured would have even in the absence of such contract or agreement."

These two instances show that the Money Concepts Policy does not consistently use the words "an insured" to mean something distinct from "'the insured." Interpreting the contract contra proferentem, as the Court must when faced with an ambiguity, the Court finds that "an insured," as used in the Money Concepts Policy's exclusion clauses, must be interpreted as a synonym for "the insured."

One consequence of this analysis is worth separate mention. The fidelity bond exclusion applies to exclude claims covered by "an insured's" fidelity bond. It appears from the record that only Money Concepts is insured under the fidelity bond at issue in this case. That is, neither Robert nor Gregory Shefchuk was an insured. Indeed, National-Union, the issuer of the fidelity bond, refused to defend either Shefchuk in the Underlying Actions on the grounds that neither is an insured under the Bond. Reading "the insured" for "an insured," the Court concludes that the fidelity bond exclusion applies only to exclude claims against Money Concepts itself that come within the coverage of the bond.

C. A "Claim" Is a Legal Theory, Not an Entire Lawsuit.

The word "claim" is not explicitly defined by the policy. Therefore, the Court should give it its plain and ordinary meaning. Fiorentino v. Lightning Rod Mut. Ins, Co., 114 Ohio App.3d 188,193, 682 N.E.2d 1099,1102 (1996). Some of Illinois Union's arguments presuppose that a "claim" is an entire lawsuit, so that any one of the Underlying Actions contains a single claim rather than

containing a claim against Money Concepts, a claim against Robert Shefchuk, etc.

Illinois Union's argument has some force, because one court has held that the plain meaning of "claim" is "a demand for something due or believed to be due." Id. This definition suggests that the word claim should be understood from the point of view of the claimant, who has suffered one loss and regards himself as having one claim, i.e., one amount that he wishes to recover. Illinois Union's argument is also supported by the use of the word "claim" in modem civil procedure. In modem pleading, a plaintiff may have one "claim for relief," even though he may ultimately recover on several legal theories and from several defendants.

On the other hand, courts have sometimes defined the word "claim" in insurance cases is such a way as to suggest that each legal theory or cause of action is a claim in itself. Thus, in Preferred Mut. Ins. Co. v. Thompson, 23 Ohio St.3d 78, 80, 491 N.E.2d 688, 690 (1986), the court held that "[w]hen a complaint against an insured states both negligence and intentional tort claims that are based upon the same occurrence, the insurance company that is contractually obligated to defend the insured in negligence actions is required to make a defense as to both claims against the insured." Here, the court clearly uses the word "claim" in the sense of "cause of action:" the plaintiff had a claim for negligence and a claim for intentional tort, even though the entire lawsuit arises out of a single "occurrence," and for the purposes of pleading practice, the plaintiff might have only a single claim for relief.

Given this ambiguity in the meaning of the word "claim" (which, the Court again notes, is not explicitly defined in the policy), the Court will interpret the policy contra proferentem. Therefore, the Court holds that a "claim" means a cause of action or legal theory entitling the plaintiff to relief.

D. A Claim "Arises Out Of" Facts or Events When It "Originates From," "Flows Out Of," or "Grows From" Them.

Under Ohio law, the words "arise out of have been held to mean "originate from," "flow out of," or "grow from." Nationwide Ins. Co. v. Auto-Owners Mut. Ins. Co., 37 Ohio App.3d 199, 202, 525 N.E.2d 508, 511 (1987); Nationwide Mut. Fire Ins. Co. v. Turner, 29 Ohio App.3d 73, 77, 503 N.E.2d 212, 217 (1986). This definition requires a causal connection between the claim and the facts or events out of which it is said to arise. However, this definition does not require proximate causation.

E. The First Sentence of the Dishonesty Exclusion Is Unenforceable

The Court finds that the first sentence in the dishonesty exclusion clause quoted above cannot serve to exclude any claims from coverage, because it is meaningless or illogical. By its terms, the clause excludes claims arising out of acts that are both (1) wrongful acts, as defined; and (2) dishonest, fraudulent, criminal, etc. But because the definition of "wrongful act" elsewhere in the policy limits that term to negligent acts, and because dishonest, fraudulent, or criminal acts are inherently more than negligent, the

clause excludes only claims that are both negligent and not negligent. This logical incoherence renders the first sentence of the clause unenforceable.

If the first sentence of the clause is unenforceable, the Court must determine the meaning to be given to the second sentence. It seems that the second sentence applies to the subset of dishonest, fraudulent, or criminal acts in which the actor acts so as to profit personally from his misdeeds. One can imagine dishonest acts that do not come within this definition. For example, suppose Gregory Shefchuk persuaded his father to guarantee forged signatures so that he (Gregory) could profit. The father might assist the son for reasons other than personal profit. In such a case, the claim against Robert Shefchuk would not come within the second sentence of the exclusion clause, although it would come within the first, unenforceable, sentence of the clause.

THE UNDERLYING ACTIONS INVOLVING ROBERT SHEFCHUK

Applying the foregoing principles to the Underlying Actions, the Court holds that Illinois Union had a duty to defend Robert Shefchuk in each of the Actions in which he was named as a defendant. , These Underlying Actions fall into several. categories:

A. Cases Alleging Wrongdoing by Robert Shefchuk or Alleging Negligence That Arises Out of His Wrongdoing

In the first category of cases,[4] the plaintiffs allege that Robert Shefchuk himself committed intentional torts or

violated statutes. The claims in some of these complaints (e.g., Meyer, et al. v. Shefchuk, et al.) are excluded from the possibility of coverage by the prior occurrence exclusion clause because the intentional torts alleged occurred prior to the effective date of the Money Concepts Policy. Because the allegations are of intentional torts, the complaints necessarily rest on the theory that Shefchuk had knowledge of his wrongdoing at the time of the tort. Even though complaints such as the complaint in Meyer also include counts of negligence, the claims of negligence arise out of the same "incident or fact situation" as the claims of fraud. Indeed, in Meyer, the Court would be hard pressed to identify any act allegedly taken by Shefchuk that was negligent but not fraudulent or otherwise tortious. Therefore; Ilinois Union had no duty to defend such actions.

Other of the Actions are barred by the dishonesty exclusion clause, or more precisely, that portion of the clause that is enforceable, given the Court's discussion of the clause, supra. In Giles v. Money Concepts Capital Corp, et al., for instance, the only allegation involving Shefchuk is that he forged the plaintiff's indorsement on a check and presented it for payment, and that he converted the proceeds of the payment to his own use. Under the second sentence of the dishonesty clause, coverage is excluded on such claims. In a subset of these Actions, Shefchuk was impleaded as a third-party defendant by American Skandia. In George v. American Skandia, for example, the third-party complaint seeks indemnification and an accounting from Shefchuk. In these cases, American Skandia has set forth no new facts relevant to Shefchuk's liability. Nevertheless, it is clear from the third-party

complaints that the only factual basis for the impleader of Shefchuk is American Skandia's claim that Shefchuk intentionally misappropriated funds. As there is no possibility of coverage under the Money Concepts Policy on such claims, Illinois Union had no duty to defend against them. The Court notes that these cases must be distinguished from the cases in which Shefchuk was named as a defendant in the complaint and in which American Skandia or another defendant cross-claimed against him. As noted above, the insurer's duty to defend is governed by the allegations in the complaint. A cross-claim is necessarily filed sometime after the complaint was filed and thus sometime after the duty to defend attached.

B. Cases in Which It Is Unclear Whether the Plaintiff Is Alleging Negligence or Intentional Wrongdoing on the Part of Robert Shefchuk

In some of the Underlying Actions,[5] the plaintiffs make allegations against Robert Shefchuk that may sound either in negligence or intentional tort. In several of the actions, e.g., Bradler, et al. v. American Skandia, et al., the allegation against Shefchuk is that he guaranteed the plaintiffs' forged signature using his Securities Transfer Act medallion. It is unclear from these complaints whether the allegation is that he knowingly guaranteed a forged signature, or whether he was merely negligent, The Court finds that a negligence claim would lie against a guarantor of a signature in such a situation. In analogous circumstances, notaries public have been adjudicated to be liable for their guarantees of forged signatures even though they were merely negligent. See Keck v. Keck, 54 Ohio App.2d 128, 375 N.E.2d 1256,1257 (1977). If the claim against

Shefchuk was merely for negligence, the exclusion clauses would not apply to exclude the possibility of coverage. Even if the negligence arose out of the forger's intentional tort, the Court's construal of the term "an insured" in the exclusion clauses precludes application of the prior occurrence clause or the illegality clause. Moreover, assuming the claim is one for negligence only, the enforceable portion of the dishonesty clause would not apply.

Because under Sanderson v. Ohio Edison Co., 69 Ohio St.3d 582, syll. at 11, 635 N.E.2d 19 (1994), the duty to defend exists if the claim is even "arguably" within the coverage of the policy, the Court finds that Illinois Union had a duty to defend Robert Shefchuk in such complaints. The Court notes that for the reasons given above, Illinois Union could have been relieved from its duty to defend if, after discovery, it had demonstrated that the allegation was in fact an allegation of intentional wrongdoing rather than negligence. However, Illinois Union made no such demonstration in this case, and thus the allegations of the complaint must govern.

In other of the Underlying Actions in this category, the plaintiffs plead intentional tort or, in the alternative, negligence. In Toth, et al v. RCS Fin. Servs., Inc., for example, the claims against Robert Shefchuk are for negligence and breach of fiduciary duty. The latter count alleges that Shefchuk intentionally stole the plaintiffs' funds or, in the alternative, that he negligently permitted others to steal them. In other of the complaints, the breach of fiduciary duty claim is not supported by specific factual allegations, but the Court notes that a fiduciary's breach of the duty of care may

be negligent, and that the complaints are not limited to a claim that the fiduciary intentionally breached the duty of loyalty. These complaints are consistent with a theory of the case in which Robert Shefchuk committed no intentional act and had no knowledge that would bring the-case within the exclusion clauses, but is rather, liable only for negligence. As noted above, even if the claims of negligence arise out of the tortious acts of another, or even if another insured had knowledge of such wrongdoing prior to the Policy's effective date, the Court's construal of the words "an insured" precludes application of the relevant exclusion clauses. Such complaints are arguably within the coverage of the Money Concepts Policy, and therefore, Illinois Union had a duty to defend Shefchuk against them.

In George v. American Skandia, Robert Shefchuk was impleaded by American Skandia, which sought indemnification from him and others. The claim is that American Skandia is entitled to indemnification."as a result of the fraud and misrepresentation of Robert Shefchuk, Gregory Shefchuk, and/or Money Concepts." On the one hand, the complaint alleges fraud and misrepresentation. On the other hand, under Ohio law, one may be liable for a merely negligent misrepresentation. Carpenter v. Scherer-Mountain Ins. Agency, 135 Ohio App.3d 316, 327-28, 733 N.R2d 1196, 1204 (1999), appeal dismissed, 88 Ohio St. 3d 1424, 723 N.E.2d 1113 (2000). American Skandia's third-party complaint does not plead any fraudulent act or representation with the particularity required by Ohio R. Civ. P. 9(B); the only allegation on which the fraud allegation could rest is the allegation in Par. 22 that the withdrawal instructions received by American Skandia bore the plaintiffs signature, guaranteed by Money

Concepts. But, as noted above, the guarantee of a forged signature may be merely negligent. Therefore, the Court finds that the possibility of coverage is not excluded by the allegations of the complaint in George and other cases in this category of Underlying Actions.

C. Cases Alleging Wrongful Acts and Negligence on the Part of Robert Shefchuk Where the Negligence Does Not Necessarily Arise Out of His Wrongful Acts

In some of the Underlying Actions,[6] the plaintiff states claims of intentional tort or other wrongful act against Robert Shefchuk, and also states claims of negligence that do not necessarily arise out of the claims of wrongful acts. Thus, in Burke v. Money Concepts Fin. Planning Centers, for example, the plaintiffs allege that Shefchuk aided and abetted in violations of several sections of the Advisors Act and related regulations and of fraud and other intentional torts. But they also allege that he negligently failed to supervise employees and failed to "recognize and act upon information demonstrating that other Defendants were acting improperly." Suppose that Shefchuk successfully defended the statutory and intentional tort claims. It could still be the case that he was liable fornegligent failure to supervise. It is not inconceivable that coverage could exist on the negligence claim, and therefore, Illinois Union had a duty to defend him.

Allport v. Money Concepts Capital Corp., et al. requires a separate discussion. In Allport, the complaint does not mention Robert Shefchuk in the general allegations of fact, though it does mention him in the counts for fraud, negligence, and breach of fiduciary duty. The Court, after reading the fraud and fiduciary duty

counts, finds that the plaintiff's factual allegations are directed at Gregory Shefchuk rather than at Robert Shefchuk. Thus, in Par. 31 of the complaint, she alleges that Gregory Shefchuk made fraudulent misrepresentations of fact to her, but in Pars. 32 and 33, she argues that both Gregory and Robert Shefchuk and the "Money Concepts Defendants" are liable for the misrepresentations. Likewise in Par. 63, she alleges that Gregory Shefchuk induced her to rely upon him, but in Pars. 64 and 65, she argues that both Shefchuks, Money Concepts, and RCS are liable for the breach of fiduciary duty. The Court finds that a fair reading of the complaint shows that the real allegations of intentional misconduct are aimed at Gregory Shefchuk. Perhaps the plaintiff is seeking to hold Robert Shefchuk liable for his son's wrongful acts on an agency theory; the Court discusses this possibility in its discussion of Cook, infra. In any case, the Court finds that looking behind the face of the pleadings, the real claim of intentional wrongdoing is against Gregory Shefchuk. Given the liberal policy in favor of coverage and against exclusion, the Court cannot find that the possibility of coverage is completely excluded in the Allport complaint. Accordingly, the Court finds that Illinois Union had a duty to defend Robert Shefchuk in Allport.

D. The Cook Case

In re Cook v. Money Concepts Capital Corp., et al. (NASD Arbitration) involves a different set of issues than the other Underlying Actions. First, Illinois Union argues that coverage is excluded in Cook under the dishonesty and prior occurrence exclusions quoted above. The Court notes that in Cook, the allegation is

that Gregory Shefchuk committed fraudulent acts under federal and Ohio law, and that Robert Shefchuk is responsible for the fraud insofar as Gregory Shefchuk was his agent. On these facts, the Court finds that the dishonesty and prior occurrence exclusions do not exclude the possibility of coverage. It is true, as a rule, that a principal may be liable for the tortious misrepresentations of his agent if the representations are authorized, apparently authorized, or within the power of the agent to make for the principal. Restatement (Second) of Agency §257. But the allegations of fact in Cook do not clearly show that the claimant's theory is that Robert Shefchuk authorized Gregory Shefchuk to make fraudulent statements. It could instead be the case that he is seeking to impose vicarious liability on Robert Shefchuk for the unauthorized acts of Gregory Shefchuk. Thus, on the basis of the complaint, it is impossible to conclude with certainty that the allegation is that Robert Shefchuk authorized Gregory Shefchuk to commit fraud. Because the allegations against Robert Shefchuk may boil down to claims of negligence and vicarious liability for the torts of another, the case is arguably not excluded by the dishonesty and prior occurrence exclusion clauses.

However, Illinois Union also cites two exclusion clauses not relevant to the other Underlying Actions. The first is the performance guarantee exclusion, which provides:

We do not cover claims which arise out of: the failure of "securities" or other investments to perform according to an insured's warranty, guarantee, or contractual agreement ...

The second is the private securities transaction exclusion, which provides:

We do not cover claims which arise out of or in connection with any unapproved "private securities transaction" or the sale of products, including life insurance products, which are not approved by the First Named Insured [i.e., Money Concepts].

The Court finds that the performance guarantee exclusion cannot operate in this case to exclude the possibility of coverage. The clause refers to "an insured's" guarantee of performance. Construing "an insured" as "the insured" for the reasons given above, the Court finds that the clause will exclude claims against Robert Shefchuk only if Robert Shefchuk himself made the guarantees of performance. The complaint alleges, however, that Gregory Shefchuk made the representations.

The Court agrees with Illinois Union that some of Cook's complaint arises out of the sale of unapproved securities, namely, the Morgan I and Morgan V real estate investments, RCS Financial Services common and preferred stock, and securities of JAB Technologies and PowerPlay Bowling Products. However, Shefchuk rightly points out that the complaint,also includes a claim regarding investment in two mutual funds. It appears that both funds were approved by Money Concepts. The allegation is that Gregory Shefchuk sent false statements to Cook regarding the state of his investments in the funds. The allegations of fraud and misrepresentations against Robert Shefchuk are not limited to the transactions involving unapproved securities: paragraph 58 of the complaint, for example,

argues that Robert Shefchuk is liable because of Gregory Shefchuk's frauds, "including but not limited to representations as to the future value of stock in Morgan 1, Morgan V, and RCS Financial" (emphasis added). Therefore, the Court finds that the complaint can be read to seek relief against Robert Shefchuk on account of the sale of approved securities. Because at least one claim is not excluded, the Court concludes that Illinois Union had a duty to defend Robert Shefchuk in this action.

THE UNDERLYING ACTIONS INVOLVING GREGORY SHEFCHUK

Applying the foregoing principles to the Underlying Actions, the Court holds that Illinois Union had no duty to defend the Estate in any of the Actions in which it was named as a defendant.

While the first sentence of the dishonesty exclusion is unenforceable, the second sentence may be enforced. The second sentence provides that Illinois Union does not cover claims "'arising out of the insured gaining any personal profit or advantage to which the insured was not legally entitled." It is undisputed that Gregory Shefchuk intentionally defrauded his clients through forged withdrawal slips and fraudulent account reports, thereby stealing funds which were not legally his. Because claims against the Estate arise out of Gregory Shefchuk gaining a "personal profit or advantage to which [he] was not legally entitled," Illinois Union had no duty under the Money Concepts Policy to defend the Estate against claims arising out of Gregory Shefchuk's conduct.

Illinois Union also had no duty to defend the Estate in those Underlying Actions which include a claim for negligence against the Estate. Under Ohio law, an insurer has no duty to defend a negligence claim where that negligence claim arises out of an act that is subject to a policy exclusion. Sphere Drake Insurance Co. et al. v. Ross, 80 Ohio App.3d 506, 509, 609 N.E.2d 1284, citing St. Paul Surplus Lines Ins. Co. v.1401 Dixon's, Inc. 5892 F.Supp. 865, 8b?-b8 (E.D. Pa. 1984). Thus, even where the Underlying Action is based upon negligence, the claim is dependent upon Gregory Shefchuk's excluded acts of unlawful personal profit, and Illinois Union has no duty to defend the Estate in these Underlying Actions.

CONCLUSION

For the foregoing reasons, Robert Shefchuk's motion (docket no. 81) is granted in part and denied in part, the Estate's motion (docket no. 124) is denied; and Illinois Union's motion (docket no. 118) is granted in part and denied in part.

This case is set for a status conference on Friday, September 28, 2001, at 11 o'clock a.m., in Chambers, Suite 3402, Key Tower, 127 Public Square, Cleveland, Ohio 44114.

IT IS SO ORDERED.
ANN ALDRICH
UNITED STATES DISTRICT JUDGE

Footnotes

fn1Kathleen A. Shefchuk is a defendant in this case as executrix of Gregory's estate.

fn2"Damages," as defined by the policy, do not include punitive or exemplary damages. In its brief, Illinois Union suggests that because several of the underlying investor lawsuits seek punitive damages, they are not within the scope of coverage. This argument fails for the reason Illinois Union itself recognizes elsewhere in its briefs: "'At no point has Illinois Union taken the position that the presence of a claim for punitive damages or equitable relief in an otherwise covered lawsuit removes the entire lawsuit from the scope of the Money Concepts Policy's coverage." (Mem. in Opposition to Motion for Summ. J. at 4 n 2). None of the suits seeks solely punitive damages or equitable relief.

fn3Illinois Union's argument that paragraph 5 governs choice of law as to the merits of the claims rather than only as to arbitrability is implausible. The most natural reading of the paragraph merely requires application of California arbitradon law to decide whether the claim is arbitrable.

fn4Meyer, et al. v. Shefchuk, er al., Case No. 96M879 (Geauga County Ct. Comm. Pl.); George v. American Skandia Life Assurance Corp., Case No. 98VH34, Chardon Mun. Ct.); Giles, et al. v. Money Concepts Capital Corp., et al., Case No. 99M 115 (Geauga County Ct. Comm. Pl.); Richards, et al. v. Pioneer Investments, et al., Case No. 99CV655 (Lake County Ct. Comm. Pl.); Savarino v. Shefchuk, Case No. 99P528 (Geauga County Ct. Comm. Pl.).

fn5Bradler, et al. v. American Skandia, er al., Case No. 98CV1303 (Lake County Ct. Comm. Pl.); Toth, et al. v. RCS Fin. Servs., et al., Case No. 98CV461(Lake County Ct. Comm. P1.); In re Williams v. Money Concepts Capital Corp., et al., Case No-98-4169 (NASD Arbitration);Anderson, et al. v. American Skandia, et al., Case No. 98CV 1194 (Lake County Ct. Comm. Pl.); George v. American Skandia Life Assurance Corp., Case No. 98VH34 (Chardon Mun. Ct.

fn6Meyer, et al. v. Shefchuk, et al., Case Nos. 96M879, 98M169 (Geauga County Ct. Comm. Pl.); Allport v. Money Concepts Capital Corp., et al., Case No. 371651 (Cuyahoga County Ct. Cormm. Pl.); Bukky, et al. v. RCS Fin. Servs., Inc., et al., Case No. 98M519 (Geauga County Ct. Comm. P1.); Burke, et al. v. Money Concepts Fin. Planning Centers, et al., Case No. 1:98CV2087 (N.D. Ohio); Ferry, et al. v. Money Concepts Fin.Planning Centers, et al., Case No. 1:99CV1141 (N.D. Ohio);

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Case No. 1:99CV2320
IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ILLINOIS UNION INSURANCE CO.,
Plaintiff,

vs.

RCS FINANCIAL SERVICES, INC., et al.,
Defendants.

JUDGMENT ENTRY

This cause came for consideration before this Court upon Defendant Robert Shefchuk's Motion for Partial Summary Judgment, Plaintiff Illinois Union Insurance Company's Motion for Summary Judgment and Defendant Kathleen A. Shefchuk, Executrix of the Estate of Gregory Shefchuk , Deceased's ("Executrix") Motion for Partial Summary Judgment, All Motions sought a ruling on whether Illinois Union Insurance Company ("Illinois Union") had a duty to defend Robert Shefchuk and/or the Executrix under an insurance policy that Illinois Union had issued to Money Concepts Capital Corporation (the "Policy"). The Court reviewed the Motions, memoranda and briefs of all parties (including any and all supplemental and reply briefs, both in support of and in opposition to the subject Motions), the pleadings, the affidavits and exhibits, and the applicable law.

The Court previously has granted, in part, Illinois Union's Motion for Summary Judgment. Specifically, this Court held that Illinois Union had no duty to defend Robert Shefchuk in the following underlying actions: Meyer, et al. v. Shefchuck et al., Case No. 96M879 (Geauga County Ct. Comm. Pl.); George v. American Skandia Life Assurance Corp., Case No. 98VH34 (Chardon Mun. Ct.); Giles, et al. v. Money Concepts Capital Corp., et al., Case No. 99M115 (Geauga County Ct. Comm. Pl.); Richards, et al. v. Pioneer Investments, et al., Case No. 99CV55 (Lake County Ct. Comm. Pl.); and Savarino v. Shefchuk, Case No. 99P52 (Geauga County Ct. Comm. Pl.). See Judgment Entry, Sept. 7, 2001.

The Court has previously granted, in part, Defendant Robert C. Shefchuk"s Motion for partial Summary Judgment on the First and Second Claims for Relief contained in his Counterclaim. Specifically, this Court held that Illinois Union breached its duty to defend Robert Shefchuk in the following actions: Meyer, et al. v. Shefchuk, et al., Case No. 98MI69 (Geauga County Ct. Comm. Pl.); Allport v. Money Concepts Capital Corp., et al., Case No. 371651(Cuyahoga County Ct. Comm. P1.); Bukky, et al v. RCS Fin. Servs,, Inc., et al., Case No. 98M519 (Geauga County Ct. Comm. Pl.); Burke, et al. v. Money Concepts Fin. Planning Centers, et al., Case No. 1:98CV 087 (N.D. Ohio); Ferry, et al. v. Money Concepts Fin. Planning Centers, et al, Case No. 1:99CV1141 (N.D. Ohio); Bradler, et al. v. American Skandia, et al., Case No. 98CV1303 (Lake County Ct. Comm. P1.); Toth, et al, v. RCS Fin. ervs., et al. Case No. 98CV461 (Lake County Ct. Comm. Pl.); In re Williams v. Money Concepts Capital Corp., et al., Case No. 98-4169 (NASD Arbitration); Anderson, et al. v.

American Skandia, et al., Case No. 9801194 (Lake County Ct. Comm. P1,); and Rollin Cooke Ill. v. Money Concepts Capital Corp., et al, Case No. 99-2100 (NASD Arbitration). See Judgment Entry, Sept. 7, 2001.

Also, the Court previously granted Illinois Union's Motion for Summary Judgment against the Executrix. The Court held that Illinois Union had no duty under the Policy to defend the Executrix in any action. In so holding, the Court denied the Executrix's Motion for Partial Summary Judgment. See Judgment Entry, Sept. 7, 2001.

The Court has reviewed a Stipulation provided by the parties. Illinois Union and Robert Shefchuk stipulate that as of October 3, 2001, Robert Shefchuk incurred $237,454.25 in attorneys' fees and costs in defending the actions listed in the previous paragraph and in prosecuting his claim against Illinois Union for coverage under the Policy. This amount does not include pre-judgment interest and does not include attorneys' fees and costs incurred after October 3, 2001, which continue to accrue in the within action.

The Court now finds, pursuant to Fed. R. Civ. P. 54(b) that there is no just reason for delay in entering final judgment on the duty to defend claims under the Policy. This Court's Judgment Entry of September 7, 2001 disposed of all contractual claims arising out of the Policy. The remaining claims are separate and distinct, and relate to a different insurance policy and a claim of bad faith. Thus, duplicate appellate review should be avoided. Finally, Defendant Robert C. Shefchuk's access to needed funds will be delayed considerably if final judgment is delayed.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that final judgment in favor of Plaintiff Illinois Union. Insurance Company and against Defendant Robert C. Shefchuk on the five underlying actions in which it had no duty to defend is entered.

FURTHERMORE IT IS ORDERED, ADJUDGED AND DECREED that final judgment in favor of Defendant Robert C. Shefchuk and against Plaintiff Illinois Union Insurance Company on the ten underlying actions in which it had a duty to defend, in the amount of $237,454.25 plus pre- and post-judgment interest at the legal rate, is entered.

FURTHERMORE IT IS ORDERED, ADJUDGED AND DECREED that final judgment in favor of Illinois Union and against Kathleen A. Shefchuk, Executrix of the Estate of Gregory Shefchuk, Deceased, on the decision that Illinois Union had no duty to defend the Executrix under the Policy is entered.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, pursuant to Fed. R. Civ. P. 54(b), the Court determines that there is no just reason for delay and directs the entry of judgment.
IT IS SO ORDERED.

Case No. 02-3714
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

ILLINOIS UNION INSURANCE COMPANY,
Plaintiff-Appellee,

v.

RCS FINANCIAL SERVICES, INC., et al.,
Defendants

v.

KATHLEEN A. SHEFCHUK, Executrix of the Estate of Gregory D. Shefchuk,
Defendant-Appellant.

Filed 11/30/2005

JUDGES: BEFORE: SILER, DAUGHTREY, and GIBBONS, Circuit Judges.

Upon consideration of the petition for rehearing filed by the appellant,

It is ORDERED that the petition for rehearing be, and it hereby is, DENIED. The opinion is also amended by deleting the last two sentences before the section titled "Conclusion."

TITLE 28

§ 453. Oaths of justices and judges

Release date: 2005-09-29

Each justice or judge of the United States shall take the following oath or affirmation before performing the duties of his office: "I, XXX XXX, do solemnly swear (or affirm) that I will administer justice without respect to persons, and do equal right to the poor and to the rich, and that I will faithfully and impartially discharge and perform all the duties incumbent upon me as XXX under the Constitution and laws of the United States. So help me God."

TITLE 28 § 2106. Determination

Release date: 2005-09-29

The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review, and may remand the cause and direct the entry of such appropriate judgment, decree, or order, or require such further proceedings to be had as may be just under the circumstances.